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DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 95-0265 IT

Gross Income Tax — Receipts Received by Agents
For Tax Periods: 1991 Through 1993

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ISSUES

I. Gross Income Tax — Receipts in an Agency Capacity

Authority: IC 6-2.1-1-2(a);
45 IAC 1-1-54;
Universal Group Limited v. Indiana Department of State Revenue, 642 N.E.2d 553, 558 (Ind.Tax 1994).

Taxpayer protests the proposed assessment of gross income tax on reimbursements for wages, employment taxes, and other employment benefits "advanced" to its employees.

STATEMENT OF FACTS

Taxpayer, an entity incorporated and domiciled in Indiana, operated under four divisions during the audit period. Taxpayer provided payroll and centralized management services for these divisions. Taxpayer also provided similar services for two corporations. Taxpayer was reimbursed for costs incurred. At issue was the characterization, for gross income tax purposes, of these reimbursements.

Audit determined the "reimbursements" represented taxable income and proposed additional gross income tax assessments. IC 6-2.1-1-2(a). At the initial hearing, Taxpayer argued such "reimbursements" were properly excluded from its taxable gross income, pursuant to 45 IAC 1-1-54, as the income was received in an agency capacity.

In upholding the proposed assessments, the Department stated:

> Because taxpayer retained the reimbursements and used the money it received to pay its own employees, the taxpayer was not acting simply as a conduit through which the

> money passed….[Therefore,] the receipts received by the taxpayer for the reimbursement of payroll services rendered must be included in taxpayer's taxable gross income.

Taxpayer subsequently protested the Department's findings and timely requested a rehearing.

I. Gross Income Tax – Receipts in an Agency Capacity

DISCUSSION

Taxpayer takes exception to two (2) of the Department's conclusions. First, Taxpayer interprets the Department's findings as condoning the taxation of "inter-divisional" transfers. As Taxpayer explains:

> [T]he Department contends certain [inter]-divisional transfers are gross income. The Taxpayer operates a number of divisions within its corporate structure. The Taxpayer maintains a certain level of accounting for each of these divisions as a management tool. Otherwise, these divisions make up one legal entity….Both the real estate division and the restaurant division maintain separate checking accounts in the [respective] division's name. Although the checking account is in the division's d/b/a (doing business as) name, the federal identification number provided to the bank and on each account is the Taxpayer's federal identification number. There are periodic transfers between the Taxpayer's checking accounts. These transfers should not be subject to gross income tax.

And second, Taxpayer protests the inclusion of "reimbursements" from other corporate entities in its state gross income calculus. Again, Taxpayer explains:

> Taxpayer and [Corporation A] and [Corporation B], each separate legal entities, operate from the same office….To avoid substantial duplication of services and personnel hours, all wages for the employees that work on behalf of [Corporation A] and [Corporation B] are paid by the Taxpayer under a management agreement between the Taxpayer and [Corporation A] and [Corporation B]. Both [Corporation A] and [Corporation B], in turn, reimburse the Taxpayer in an amount equal to the wages paid the employees working on each respective entity's behalf.

The Department notes, as a preliminary matter, that the initial letter of findings did not contain language dictating the inclusion of "inter-divisional" or "intra-corporate" transfers in Taxpayer's taxable gross income. To the extent such an interpretation was made, it is in error.

In the initial letter of findings, the Department determined reimbursements for employee services provided to third parties represented prima facie evidence indicating the income did not "pass through" to another. The Department found that Taxpayer (as employer) received a beneficial interest in the "reimbursements" because the income was used by Taxpayer to pay its own expenses—i.e., used to meet its payroll obligations. In other words, the income did not "pass through" to a third party; Taxpayer was not receiving this income in a agency capacity. The Department based its conclusion on language offered by the Indiana Tax Court in a case with seemingly analogous facts:

> [A]ssuming *arguendo* the arrangements created agency relationships, there was no pass through. The reimbursements to the corporations that performed the administrative tasks were reimbursements for those corporations' own expenses, **such as paying their own employees' wages**, not for monies advanced to third parties.
>
> Indeed, the entire beneficial interest in the reimbursements lies with the parties receiving the reimbursements. **That these are true reimbursements without any profit to the recipient is irrelevant:** "[t]he gross income tax is applicable regardless of any profit being involved." *Western Adjustment* 236 Ind. at 645, 142 N.E.2d at 633. Whether these transactions should be taxable, as a matter of tax policy, is a matter for the legislature, not this court (emphasis added).

Universal Group Limited v. Indiana Department of State Revenue, 642 N.E.2d 553, 558 (Ind.Tax 1994).

Taxpayer argues an employer receiving "reimbursements" for wages paid to its own employees working for another does not, on its face, represent a "beneficial interest." Taxpayer prefers a less dogmatic, more pragmatic, conceptualization of "beneficial interest." Rather than focusing on the employee-employer relationship, Taxpayer suggests "[t]he most important factor in determining whether the agency receipts [i.e., reimbursements] are taxable is [determining] whether the agent [employer] benefited directly from the receipts." Taxpayer argues that under this more "pragmatic" approach, no beneficial interest accrued.

The Department finds merit in Taxpayer's argument. Taxpayer employed a certain number of employees; these employees performed work exclusively for Corporation A and Corporation B. Taxpayer received reimbursements for its own payroll expenses from Corporation A and Corporation B. The employees, however, performed no work for Taxpayer and the reimbursements only "covered" Taxpayer's payroll expenses—including benefits. From these facts, the Department concludes that Taxpayer did not receive a "beneficial interest" in this income. Rather, Taxpayer received the reimbursements in its capacity as agent. The income represented by the reimbursements should not have been included in Taxpayer's Indiana gross income.

FINDING

Taxpayer's protest is sustained.

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